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# PRIVATIZATION AND INDIA'S ECONOMIC REFORMS

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Abstract

Despite the early success of India's economic reform program, the public sector deficit continues to pose a major threat to the vitality of the Indian economy. The fiscal deficit, it is concluded, has been exacerbated by the continual growth and inefficiency of India's public sector enterprises. In the aggregate, rates of return on investments to public sector enterprises have been negative. This paper examines how a program of privatization of India's public sector enterprises can serve to redress the fiscal imbalance in the country. It is concluded that a comprehensive privatization program could seriously reduce the strain on government revenues, as well as contribute to improved efficiency and competition in the economy.

# PRIVATIZATION AND INDIA'S ECONOMIC REFORMS

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The malaise of public sector financial indiscipline which contributed in a major way to India's balance of payments crisis about three years ago, still continues to be a major issue. Indeed, with the supply response to the reforms programme so far being relatively weak, and with the public sector finances likely to he under pressure because of, among others, the need to put in place effective safety. net programmes, the country's public sector deficit may continue to be on the high side. This is an issue that poses a major risk for the success of India's economic reforms programme and therefore needs to be urgently addressed.

This paper *explores* how privatization of public enterprises can be of help in addressing the crisis in India's public sector finances and thereby in contributing to the success of the country's economic reforms programme. It first reviews, in Section 1, the current status of India's public sector finances and briefly indicates its implications for the country's economic reforms programme. Section 2 briefly explores how privatization can be of help in reducing India's public sector deficit. Section 3 evaluates India's recent privatization moves, focusing especially on the incentives underlying them. Section 4 analyzes the obstacles to privatization, with Section 5 proposing a privatization policy for India. Finally, Section 6 presents some concluding remarks.

## 1. India's Public Sector Finances

Two points need to be made here. The first relates to the size of India's public sector deficit. Although precise data on

India's public sector deficit are not available, the available evidence clearly suggests that it continues to be substantially higher than what is sustainable. The deficit of the Government of India (GOI) alone, given the guesstimates currently available, easily adds up to around 6% of GDP for the current year (see Chelliah 1994), against 4.7% of GDP1/ budgeted by the GOI. The deficit is running higher because of several *factors,* including (a) substantial shortfall in revenue collections, with the customs duty collections alone running as much a5 18.3% lower than the target; (b) additional expenditures on the new schemes announced by the Prime Minister on August 15, 1993; and (c) higher food and fertilizer subsidies. *The GOI's deficit will be* still higher if account is taken of the capital contribution of Rs. 57 billion in the form of 10% interest-bearing bonds that. i-t has provided for in its 1993-94 budget to meet the gap in the nationalized banks' provision *for* bad and *doubtful* debts. The GOI's deficit calculations *do* not *reflect this contribution-* Why? The Finance Minister has provided an answer to this question in his 1993-94 budget speech. This is what he said: "There will be no immediate net outgo from the budget, as the Government's contribution is in the form of Government bonds; but the interest payment on these bonds, and their ultimate redemption will be a real burden on the budget in future. This is the price we have to pay for having long tolerated management practices in the banks and types of lending which paid inadequate attention to portfolio quality and recoveries" (Government of

India 1993a, p. 6). This does not sound convincing. The question that one would like to ask is: How will the GOI treat the above contribution in its books? It seems that it will treat the contribution as a 1993 94 expenditure, to be financed through the issue of its bonds which will add to its internal debt. Given this and given the way the GOI defines its deficit, there is a strong case for correcting the 1993-94 fiscal deficit numbers to reflect the above contribution of Rs. 57 billion. The point that needs to be appreciated here is that while the economic effects of the bad bank management practices and bad bank loans in question have already taken place, it is only now that the GOI has recognized the price to be paid by it for the public sector bank managements' past shortcomings. This being the case, the GOI does not have an alternative but to correct its deficit numbers. If it does not, it will set a very bad precedence, in that it *may one* day even issue bonds in payment of its employees' salaries, with the amount involved not taken into account for calculating the deficit on the ground of that involving "no immediate net outgo from the budget"!

As regards the deficits of other public entities, things are equally bad, if not worse. A recent assessment of the State Governments' finances (Reserve Bank of India 1993) puts their current year's (1993-94's) deficit at 3% of GDP. As regards the public enterprises, the Central Statistical Organisation's latest (1993) National Accounts Statistics put their most recent (1990-93.) deficit at Rs. 249.4 billion, or 4.7% of GDP. Given the substantial increases in the losses of public enterprises such as state electricity boards and state road transport corporations, there is reason to believe that the public enterprises' deficit currently (1993-94) may be substantially higher than that for 1990-91. No data on the deficits of the remaining public entities (e.g., local governments1 are available, but there is reason to believe that their deficits add up to substantial amounts.

Although the above deficit numbers on the major components of India's public sector are nut strictly comparable and also suffer from the limitation that they make no adjustment for the intra-public sector transfers (e.g., GOI's budgetary support to finance the central public enterprises' investment outlays), they nonetheless clearly suggest that India's public sector deficit is very large. An alternative estimate, arrived at by consolidating the public sector's financing requirements, also suggests that the deficit is very large -- 18.4% of GDP in 1989-90 (Gupta 1993).

The second point that needs to be made is that much uf the public sector deficit in India is because of the unrelenting growth in public spending and that too generally of a poor quality. According to a recent study (Rao 1992), public spending on the maintenance of economic assets has suffered a substantial erosion between 1971-72 and 1987-88.2/ What is most unfortunate is that while the maintenance of economic assets has been allowed to suffer, substantial increases have taken place in public spending on items such as interest payments, subsidies, and wages and salaries. The interest payments of the GOI alone currently (1993-94) add up to Rs. 380 billion, 4.9% of GDP, and these payments currently absorb as much as 45% of the GOI's total current revenues, up from 25.5% in 1984-85. Interest payments have piled up because substantial amounts af money have been borrowed, and continue to be borrowed, to finance even current expenditures. Even when borrowed *money* has been used to finance capital spending, the return generally has been substantially less than the interest cost involved, as Dandekar (1994) and Gupta (1988) have shown.

Subsidies, implicit and explicit, add up to about 15% of GDP, according to Meghnad Desai (cited in Aiyar 19933, with the power subsidy *alone* currently adding up to about 9% of GDP (The Economic Times 1993e). With the power sector's management currently being politically determined, power is supplied virtually free to agriculture, which *consumes* about one-third of the national output. As regards the expenditure on wages and salaries payable to public sector employees, it adds up to a very high figure. According to the Central Statistical Organisation (1993), wages and salaries paid to the central, state and local government employees alone amounted to Rs. 430.8 billion, 7.1% of GDP, in 1991-92, up from Bs. 80.4 billion, 5.9% of GDP, in 1980-81. One can argue that much of the growth *in* public spending can be attributed to the special interest groups' stranglehold over India's public sector finances. Indeed, the special interest groups' stranglehold over India's public sector finances seems to have increased, not lessened, in recent years, notwithstanding the economic reforms in the country. The latest example clearly suggesting this is the Prime Minister's recent announcement that each member of the Parliament (MP) would get Rs. 10 million each every year for spending on "local area development projects" of his or her choice. The announcement. which the former chief justice of India, Justice E S. Venkataramaiah, is -reported to have said to be against the spirit of the constitution (see The Times of India 1993c), will cost the exchequer about Rs. 8 billion annually, apart from increasing the level of political interference in development administration. "The ground reality", as the noted columnist Nikhil Chakravarty (1994, p. 5) has put it, "is that though an MP may not be able to pocket the money for personal or party benefit, there is no doubt that the projects can be manipulated in a manner which will bring returns to the MP without, in any way, violating the rules on paper." And with the Prime Minister himself having set the example, the Chief Ministers may soon follow suit and announce similar perks to members of their respective state legislative assemblies. This is an extremely unfortunate development. Rather than send a message of austerity to a nation still in the throes of a fiscal crisis, the Prime Minister has indulged in a reckless act of fiscal profligacy.

The above discussion provides a ffavour of the public sector financial indiscipline that India continues to be plagued with.

One can assert that this indiscipfine poses a major risk for the success of India's economic *reforms* programme. The risk arises from several sources. The continuance of high public sector deficit leads to high levels of borrowing by the GOI from the Reserve Bank of India which, through its expansionary impact on money supply, generates inflationary pressures in the economy. And this means trouble -- it will put pressure on the government to keep interest rates high; it may also affect the competitiveness of India's exports. High public sector deficits can also contribute to large current account deficits in the balance of payments which, depending on what happens to foreign direct investment and other nondebt-creating inflows, can again aggravate the problem of external indebtedness. Finally, large public sector deficits also preempt a substantial proportion of domestic savings to finance public spending, with the consequent scarcity of resources for productive investment adversely affecting the economy's *growth.*

## 2. How Privatization Can Help

India has *a huge* public enterprise sector. It consists of nearly 1,050 public enterprises -- some 250 central public enterprises (CPEs) and about 800 state public enterprises (SPEs). At the end of 1991-92, there were 246 CPEs, up from 171 at the end of 1980-81. Total investment in the CPEs at the end of 1991-92 added up to Rs. 1,358.71 billion; up from Rs. 211.02 billion at the end of 1880-81. Although detailed information on the SPEs is not available, they also account for substantial investments.

But public enterprises (PEs), both CPEs and SPEs, are, as Bhagwati and Srinivasan (1993, p. 47) have put it, "immensely inefficient". They have also been a major contributor to India's public sector deficit, with the contribution of the PEs in the energy sector alone adding up to over 4% of GDP (Gupta 1992). The PEs' deficits have added to the country's current large stock of domestic and external public debt which, in turn, has given rise to massive liabilities on account of interest payments -- as indicated earlier, the interest payments of the GOI alone, which has financed much of the investments in the country's public enterprise sector through borrowings on its account, currently add up to Rs. 380 billion, 4.9% of GDP.

Given the above, privatization of public enterprises can be of substantial help. First, privatization can be of major help in reducing India's public sector deficit. The proceeds from the sale of public enterprises can be used to finance the public sector deficit or, in case the proceeds exceed the deficit, to reduce the outstanding public debt, both domestic and external.31 This, in turn, will reduce the burden of interest payments and thereby the deficit. Thus, given the deficit's adverse macroeconomic effects, privatization can mean big economic gains for India and thereby contribute to the success of the country's economic reforms programme.

Second, privatization can also help by making the Indian economy more efficient and competitive -- that is, by creating conditions which will have the effect of private owners delivering better products at lower cost. This can happen because featherbedding and payroll padding of workers and managers alike, which occur in the public sector because there is no bottom line and no discipline of the market (Hanke 1987, cited in Bienen and Waterbury 1989), will be greatly reduced and costs streamlined. A recent World Bank study of privatieations in Chile, Malaysia, Mexico and United Kingdom (Galal end others 1992) has shown the economic efficiency gains that can result from privatization. There is reason to believe that this can happen in India too.

### 3. India's Recent Privatization Moves

The GOI has recognized that "the public enterprise sector has not generated internal surpluses on a large enough scale and, because of its inadequate exposure to competition, has contributed to a high cost structure" (Government of India 1992, p. 167). Given this recognition, the GOI is claimed to have formulated a strategy for dealing with public enterprises. The strategy has several components, with privatization of public enterprises being a major one.4/

According to Bhagwati and Srinivasan (1993), India has made two types of privatization moves: sale of a public enterprise's fractional equity or dilution of its equity, with the controlling ownership and management continuing to remain in the public sector; and "true privatization" under which the control and management of a public enterprise is transferred to the private sector {though some public sector equity holding, without managerial intervention, may continue). This section evaluates these moves, focusing especially on the incentives underlying them.

3.1 Sale of Fractional Equity or Dilution of Equity, With Controlling Ownership and Management Retained in Public Sector:

The GOI has put in place a programme to se22 fractions of total equity in selected public enterprises. Five such safes have so far been organized: two during 1991-92 when 0.3% to 20% of the total equity in 30 central public enterprises (e.g., Bharat Heavy Electricals, Bharat Petroleum, Hindustan Zinc, Mahanagar Telephone Nigam and Steel Authority of India) was sold for Rs. 30.4 billion, and three during 1992-93 when 0.2% to 5% of the total equity in 20 of the above 30 central public enterprises was sold for Rs. 19.1 billion. Thus the maximum equity of a public enterprise that was sold during these five rounds of sales added up to 25.1% for Hindustan Zinc, with the minimum amounting to a mere 0.3% for Indian Railway Construction Company. The GOI has budgeted a receipt of Rs. 35 billion on account of such sales during the current year (1993-94), but so far no sales have taken place.

All the 30 public enterprises whose fractional equity was sold during 1991-92 and 1992-93 were reporting profits and thus were in conformity with the GOI's decision that only profit-making enterprises' equity will be sold. But with the central public enterprises reporting profits for the year (via., 1990-91) immediately preceding the year when the programme for selling their equity was put in place numbering 124, one does not know how the GOI identified the 30 central public enterprises in question.

In addition to the move to sell a fraction of the existing equity, there is also a move to dilute the expanded equity of some public enterprises. The Oil and Natural Gas Corporation (ONGC), for example, has plans to dilute its equity by 20% -- with 10% to be diluted through an offer in the Indian capital market and the remaining 10% in the international market. The ONGC, which until recently stood for Oil and Natural Gas Commission and which is now a corporation registered under the Indian Companies Act of 1956, proposes to put in place a financial restructuring plan, involving revaluation of its assets, which will help it to substantially expand its equity base. Soon after the plan has been put in place, it will offer shares of a face value of Rs. 10 each at a premium of Rs. 75 per share and raise a massive sum aggregating Rs. 30 billion.

The issue of sale of fractional equity or dilution of equity by public enterprises in India raises many questions, including: What has provoked the GOI into putting in place a programme for selling fractional equity of central public enterprises? Why has most of the equity that has been sold so far, has been sold only to public entities such as Unit Trust of India, General Insurance Corporation of India and Life Insurance Corporation of India? What has the programme of selling 30 central public enterprises" fractional equity achieved, other than enabling the GOI to reduce its deficit? What is the provocation for the ONGC planning to go in for dilution of its equity?

The idea of selling the central public enterprises' equity is a part of the adjustment programme that the GOI has put in place in response to the economic crisis that the country faced in 1991. Given the severity of the crisis, the GOI had no sensible alternative but to put in place an adjustment programme and, as a critical part of it, take measures to substantially reduce the country's large public sector def icit. Indeed, the country badly needed a strategy for addressing the deficit problem. And given the huge size of the country's public enterprise sector, it was felt that selling the public enterprises' equity could be a major component of this strategy. But with the public enterprise sector regarded as a sacred cow in the political arena, the selling had to be performed in a manner that appeared to be totally harmless. This explains why only a fraction of the equity was sold, and that too almost wholly to public financial institutions, with the Unit Trust of India alone, for example, accounting for 89.4% of the total sales in 1991-92. This was done, as the Minister of Finance put it in response to a calling attention motion in the Rajya Sabha, "as it was the government's intention to ensure that the benefits accrued to public sector institutions rather than private entities in the event of the safes taking place at an underpriced Level" (see The Times of India 1993a). So much so that even the minimum reserve prices for the shares that were sold were fixed on the basis of the recommendations of financial institutions (e.g., Industrial Credit and Investment Corporation of India, Industrial Development Bank of India) in the public sector. Despite all these precautions, a lot of hue and cry has been raised and the GOI has been severely criticized, both within and outside the Parliament, with the major criticism being that the actual amount realized from the sale of shares has been substantially lower than what could have been realized by going in for the best value method and, as a consequence, the GOI has suffered a major loss (see Mishra, Nandagopal and Mohammad 1993).

As regards the ONGC, it is planning a 20% dilution of its equity as part of the conditionalities attached to a $250 million hydrocarbon sector loan that it has negotiated with the Asian Development Bank (ADD). The first tranche of $125 million was released immediately after the ADB Board had sanctioned the loan, with the second and final tranche of $125 million to be released only after the conditionalities specified in the agreement entered into with the ADB have been satisfied. The ONGC was supposed to have completed the dilution of its equity by August 1993, but there have been delays, largely because of the institutional environment that it operates in.

In my view, the whole thing does not add up to much. The ONGC's intention is not to privatiae -- its intention is just to raise the resources that it needs. The GOI's intention was also not to privatize. Its intention simply was to raise resources by selling the equity in question to other public entities under its administrative control, so that it could claim to have reduced its deficit. Therefore. the question of the GOI having suffered a major loss does not arise. All that the GOI's scheme has done is that it has changed the intra-public sector holdings of financial assets, with the result that rather than the GOI borrowing money to finance its deficit, it is the public financial institutions which have ended up doing the borrowing in order to finance the acquisition of the concerned public enterprises' equity. 5/ This incidentally shows how the International Monetary Fund's laxity has distorted the GOI's behaviour: by agreeing to a conceptually absurd definition of the deficit, it has created incentives for the GOI not to push ahead with necessary tax and expenditure reforms and instead has allowed it to go in, for gimmicks such as selling the central public enterprises' equity to other public entities in order to reduce its deficit which, in turn, given the substantial transaction costs involved, has added to wasteful public spending in the country.

3.2 <u>True Privatization</u>:

India does not have a programme for true privatization, under which the control and management of a public enterprise is transferred to the private sector (though some public sector equity holding, without managerial intervention, may continue). But still there has recently been a lot of talk about privatization, with a large number of stories carrying captions such as "Orissa to Privatize State Transport" (The Economic

Times 19925, "MP May Privatize Minor Narmada Projects" (The Economic Times 1993b), "Privatization Fever Grips State" {The Times of India 1993b) and "ITDC Privatization Plan Being Reviewed" {The Economic Times 1993d) having appeared in the press during the last about two years. One also finds cases in which privatization has already been completed. In addition, there are cases in which currently privatization is in progress. There are also cases of public enterprises which were put up for privatization, but could not be privatized. A complete list of all privatization *cases is not* available, but a review of the available material and discussions with some knowledgable people, including the participants (senior Indian Administrative Service officials) in a programme on "Restructuring of India's Economy" organized recently at the Indian Institute of Management, Ahmedabad, have generated information suggesting at least 26 cases in which privatization either has been completed or given up or is currently in progress. These cases relate to: Allwyn Nissan Limited; Andhra Pradesh Scooters Limited; Assam Polytex; Assam State Textile Corporation; Assam Syntex; Bargarh Sugar; Bhadoi Woollens Limited; Bharat *Electronics* Limited (Taloja Unit); Composite Products Centre; Delhi Electricity Supply Undertaking (part of the distribution network); Hyderabad Allwyn Limited; Indian Iron and Steel. Company; Karbi Langpi Hydroelectric Project; Konarak Jute; Maruti Udyog Limited; Nayagarh Sugar; Orissa Cements; Punjab Breweries; Punjab Wireless Systems Limited; Scooters India Limited; Tungstun Development

Corporation; Uttar Pradesh Auto. Tractors; Uttar Pradesh Instruments; Uttar Pradesh Power Generation Corporation; Uttar Pradesh State Cement Corporation (Dala Unit); and Uttar Pradesh Tyres and Tubes.

Reddy (1992) has done a micro study on the privatization of Allwyn Nissan Limited. Some material is also available on the cases relating to Andhra Pradesh Scooters Limited, Assam Polytex, Assam State Textile Corporation, Assam Syntex, Indian Iron and Steel Company, Maruti Udyog Limited and Scooters India Limited. No material on the remaining 18 cases is available. This major limitation notwithstanding, two things can still be said about the privatization moves in India. First, privatization in India appears to be a public finance-driven phenomenon. Thus, Allwyn Nissan Limited (ANL), which incurred losses in all the years since its inception in 1984, had to be privatiaed in *1988* when the Government of Andhra Pradesh (GOAP), which controlled and managed the ANL before its privatization, could not afford to provide a budgetary support of even Rs. 50 million for its revival (Reddy 1992) -- due to the considerable financial pressures that the GOAP has been under in recent years, it has not been in a position even to fully provide the resources required *for* financing the World Bank-supported projects in the state. Similarly, the Government of Assam had to go in for the privatization of Assam Polytex, Assam State Textile Corporation and Assam Syntex when it could no longer afford to finance their losses (Baruah 1993). The story is no different for the Indian

Iron and Steei Company (IISCO), which at the end of 1992-93 had accumulated losses of Rs. 3.1 billion against its paid-up capital of Rs. 3.9 billion (The Times of India 1994; and Government of India 1991), and Scooters India Limited (SIL) whose accumulated losses at the end of 1992-93 stood at Rs. 3.8 billion against its paid-up capital of only Rs. 78.1 million (Mitra 1993; and Government of India 1991). The GOI has initiated moves for the privatization of both of these enterprises -- SIL was put up for sale in 1988 and IISCO's privatization is currently in progress.

And second, it appears that privatization has contributed to gains on the efficiency front. Reddy's micro study (1992) has documented the gains that have resulted from ANL's privatization: the market share of ANL, now known as Mahindra Nissan Allwyn Limited, in the fiercely competitive light commercial vehicle market which was 17% before privatization rose to 21% at the end of 1990-91 (the latest year covered by the study); it made an entry into the export market and improved its status from being a loss-making company to a net profit-making one in 1990-91; reflecting the good performance; its share price rose from Rs. 7 (par value: Rs. 10) before privatization to a high of Rs. 28 during 1990-91. Information on the performance of other privatized enterprises is not available, but there is reason to believe that their performance after privatization has also been substantially better than that before privatization.

## 4. Obstacles to Privatization

Of the: privatization moves that have been initiated in India so far, some (e.g., those relating to Scooters India Limited and Indian Iron and Steel Company) have either been given up or are currently in progress. Complete information on the cases in which privatizations have been put in place is not available, but one can almost assert that these cases do not add up to much: assets of the public enterprises that have been privatiaed do not, there is reason to believe, add up to even 1% of the total assets of India's public enterprise sector. Why? Given the strong case for privatization, this sounds like a very relevant question to raise. And the answer probably lies in one or the other or in a combination of the following obstacles to privatization in India: structure of incentives that India's politicians face; and labour unions.

### 4.1 Incentives Facing Indian Politicians:

The internal rate of return that the business of politics offers in India is pretty high. Given this, politicians naturally want to get reelected. This explains the cut-throat competition for votes that one witnesses -- votes for getting reelected, for example, as an MLA (Member of a State Legislative Assembly) or an MP (Member of Parliament), and for getting reelected and then surviving as a Chief Minister *or* as Prime Minister. And it is here that public enterprises, which politicians use as milch cattle, come in handy: access to the public enterprises' resources helps politicians in getting reelected. This can happen in a variety of ways. First, public enterprises can be used to create and provide jobs, at wages and salaries higher than the market rates, to those who directly or indirectly help a politician in his or her reelection -- in India it is much easier to create a job in a public enterprise than in a government department. This explains the phenomena of gross overstaffing and inefficiency in public enterprises. To illustrate: the Bihar State Road Transport Corporation is reported to be employing over 15 people per bus in the Corporation (see The Economic Times 1993a); and the cost of producing sugar in Government of Bihar's (GOB) sugar mills ranged between Rs. 9 and 245 per kilogramme -- six of the mills that were closed in 1992 were operating so inefficiently that their closure has enabled Lha GOB, even with the employees continuing to be paid their salaries, to reduce its budgetary support to finance their lasses by Rs. 70 million a year (Singh 1993).

Second, public enterprises can be used as parking places for selected members of a rival group within a political party, or for such other people whose support may be critical for the continued survival of, say, a Chief Minister. These people can be nominated or appointed as chairpersons or as members of the boards of selected public enterprise corporations. This is a standard practice in India, with the recent appointments to the boards of Gujarat's public enterprises being an example.6/

Finally, public enterprises can also be milched through leakage5 in, say, their spendings under various heads, bath current and capital. Thus, plant and machinery required for *implementing* a public enterprise's investment projects, especially projects of a public enterprise operating in a regime of administered (cost-plus) pricing, may be acquired at inflated prices, with at least a part of the difference (between the market price and the actual price charged to the public enterprise) directly or indirectly accruing to a politician. And the resources so acquired can be *used* for facilitating the engineering of political defections, for financing the huge reelection expenses, and for many other purposes.

Given the above state of affairs, no wonder most politicians oppose privatization of public enterprises. especially now when, thanks to the economic reforms (e.g., substantial relaxation in the industrial licensing regime, removal of some of the price and distribution controls) that have been put in place, some of the opportunities for rent-seeking that the politicians *used* to thrive on, have disappeared. The Indian Iron and Steel Company (IISCO), employing about 35,000 workers and having a negative net worth of Rs. 4.2 billion at the end of 1992-93, is a good example of the politicians' opposition to privatization. With the IISCO management not being able to raise *on* its own the huge resources required for financing its modernization and with the GOI also not being in a position to provide the required resources through budgetary support, the GOI has decided to privatize the company and has even found a buyer in Mukund Iron and Steel Limited. But as IISCO, which earlier used to be in the private sector, was acquired by the GOI under two acts of the Parliament (viz., The Indian Iron and Steel Company (Taking Over of Management) Act of 1972 and The Indian Iron and Steel Company (Acquisition of Shares) Act of 1976), parliamentary approval is necessary before the privatization can be put in-place. Two bills to repeal these acts and thereby to seek the Parliament's approval for IISCO's privatization were listed for introduction in the Lok Sabha on December 23, 1993 but, given the members' vehement protest, they had to he referred to a parliamentary committee. The GOI's Minister of State for Steel is reported to have sought the support of the committee, called the Parliamentary Consultative Committee for Privatization of the Indian Iron and Steel Company, but his fervent appeal has not received any favourable response so far *(see* The Times of India 1994).

4.2 Labour Unions:

The labour unions' opposition has been a major factor responsible for the failure or the slowing down of privatization efforts in 'India. The Scooters India Limited (SIL) is a case in point. The SIL, which was put up for sale in 1988, was lucky to find a buyer in Bajaj Auto Limited (BAL), a major scooter producer in the private sector, but the sale could not go through because of the *opposition* of *the* SIL's 3,125 employees to the proposed scheme of privatization which involved retrenchment of 1,625 employees.7/ "The real problem", as Rahul Bajaj, BAL's Chairman, put it, "is the labour. If in even one case the Government closes down a unit because employees oppose privatisation, then the problem will be partly solved, as people will see that saving half the jobs is better than having none" (Bajaj 1988, cited in Pendse 1991, p. 299).

Bajaj is right. Closure does help. *But the GOI has not* heeded to Bajaj's advice and has instead allowed SIL to continue to incur huge losses. 'This suggests how much, in present value terms, the SIL labour union's adamancy or more appropriately the current legal environment in India which does not allow the employers in the organized sector to close down their plants or to retrench workers or even to fire workers on grounds of indiscipline while keeping the total labour force unchanged and thereby creates incentives for the labour unions to behave in an adamant manner, has cost India's public sector. Thus, it is *not just* the SIL's losses since 1988 that one needs to consider. What also needs to be considered is the substantial erosion that may have taken place in its market value -- BAL had an added incentive in acquiring SIL in 1988, in the sense that it would have enabled it to acquire additional licensed capacity to produce scooters; with industrial licensing far scooters gone. BAL has no such incentive now.

## 5. A Suggested Privatization Policy for India

Bhagwati and Srinivasan (1993, p. 52) "suspect that, since many public sector enterprises impinge directly on the consumers, the demand for privatization and for competition regardless is currently ahead of the supply, and that the hesitation of the government to proceed more expeditiously with the task reflects excessive caution.... the outrage, over the failure of *power,* airlines, telephones and communications to function with efficiency has grown, especially as the possibility of alternatives has become a reality, thanks to the reforms to date. The worldwide movement towards privatization also reflects similar experience, and is based on pragmatic experience rather *than on an ideological preference for the private sector."* While I fully agree with Bhagwati and Srinivasan's assessment, one more point needs to be noted. And that relates to the GOI's growing uneasiness with the implications of "the heavy unmet demands for expenditure in critical sectors such as education and health, where larger expenditures are necessary for the well-being of the poor" (Government of India 1993c, p. 18).

Given the above scenario, one may argue that the supply of privatization in India will have to match the demand for it. It therefore appears that the obstacles to privatization, discussed in Section 4, may start wearing down and genuine privatization *of* public enterprises may proceed more expeditiously. With India having no social security system in place, this will certainly cause a lot of pain5 as hundreds of thousands of workers currently *employed in* grossly averstaffed public enterprises *are* rendered jobless. Which suggests an urgent case for strengthening the National Renewal Fund (NRF) to ease the adjustment problems of workers when retrenched. This will have to be an extremely critical component of any sensible privatization policy for India. The point that must be appreciated is that while a large number of people will gain from privatization, many will lose. And a strengthened NRF can be expected to go a long way in easing the adjustment problems of the losers.

The second component of the privatization policy for India relates to the identification and sequencing of public enterprises to be privatized. There is a lot of confusion that currently prevails on this issue. Some people (e.g., Mishra and Nandagopal 1989; Trivedi 1993) have divided public enterprises into different categories and then have proceeded to identify the categories of public enterprises that may be privatized. Mishra and Nandagopal (1989), for example, have divided the central public enterprises into four categories (viz., financially successful public enterprises in competitive markets, financially successful public enterprises in noncompetitive markets, financially unsuccessful public enterprises in competitive markets, and financially unsuccessful public enterprises in noncompetitive markets) and have argued that only financially successful public enterprises in competitive markets could be considered as suitable candidates for privatization.

This approach to privatization suffers from two limitations. First, the criteria used to determine financial success and competitiveness is conceptually weak. Financial success of a public enterprise could be due to the high protection that it may be enjoying at a given time. Which means that with protection levels being lowered as part of the current economic reforms programme, a public enterprise which may be financially successful in, say, 1993-94, may not be so in 1994-95. One can also question the criteria used to divide public enterprises into competitive and noncompetitive categories. Consider, for example. Steef Authority of India Limited (SAIL) and Bharat Heavy Electrica3.s Limited (BHEL) which have been categorized- as noncompetitive public enterprises. With both SAIL and BHEL producing tradable goods and subject to competition, such a categorization does not seem to make any sense and Ramanadham (1989) therefore has rightly questioned it.

Second, the rationale offered for not considering certain categories of public enterprises as suitable candidates for privatization does not appear to be very convincing. Rao (1993, P. 1Ø), for example, argues that "the successful enterprises in noncompetitive markets should be exposed to competition, by breaking them into competing smaller units, and then privatized. The financially unsuccessful enterprises in competitive markets should be reformed by sharper focus on profits, tighter management, and even perhaps leasing out to turnaround professionals. The unsuccessful enterprises in noncompetitive markets will have to be restructured, and if they do not improve, sold off or closed down." Why should all financially successful public enterprises in noncompetitive markets, even those producing tradable goods, be broken *into* smaller units in order to expose them to competition? Can't they be exposed to competition by freely allowing imports at zero or low tariffs?

Even the ones producing nontradable goods can be privatized without breaking them into smaller units one can think of ways of properly regulating them. As regards the financially unsuccessful public enterprises in competitive and noncompetitive markets, one can try the routes Rao (1993) has suggested but, given the massive empirical evidence on the experience with public enterprise reforms (see The World Bank 1992), they probably will only delay the privatization of a large number of public enterprises.

In my view, public enterprises have no business to be in areas where no public purpose is served by their presence. Given this, India needs to privatize most of its public enterprises.8/ The relatively small ones may be privatized first. This will allow the concerned authorities to gain experience as also to minimize the risk involved.

The third component of the privatization policy for India relates to the following issues: Whom should a given public enterprise be sold to and at *what* price? Should it be sold to the highest bidder, with the new management allowed to use the acquired assets in any legally permissible manner that he wants, *or* should it be sold to a buyer who will run the enterprise to produce the same goods that it is currently Producing, but will manage it better? My preference will be to sell to the highest bidder in all cases, except the ones in which selling to the highest bidder may lead to immediate dislocations in critical infrastructure-supplying sectors (e.g., telecommunication, power). One can argue that such an approach will not only improve the allocation of resources in the economy but will also enable the government to realize better prices than the discounted values of future income flows from the privatized enterprises.

In order that the potential buyers may be able to properly evaluate the public enterprises put up for sale, it will be highly desirable to ensure the finalization of their pending accounts as soon as possible -- the Delhi Electricity Supply Undertaking's accounts for the past two years, for example, were recently reported to be not ready (see The Economic Times 1993c). It will also be highly desirable to prepare a status paper on each public enterprise, giving detailed information on its fixed assets, receivables and payables, as also on the subsidies, explicit and implicit, and the proteotion that it currently gets, and the social and other constraints that affect its working.9/ This will enable a potential buyer to assess, among other things, how much of the profit of a given public enterprise, adjusted for the effect of social and other obligations, is on account of the subsidies and protection that it gets and how much on account of its efficiency.

Finally, given the urgency and the magnitude of the task involved, it will he desirable to put in place an action plan which may be called Ten Year Privatization Plan. It could be formulated and implemented by a separate office, called. Privatization Office, consisting of first-rate professionals.

The GOI could take the lead in creating the Privatization Office, with State and Union Territory Governments and Local Authorities encouraged to avail of its services. The Office will be responsible for drawing up the fists of public enterprises to be privatiaed each year, finalization of their pending accounts, preparation of status reports on them, and management of all the remaining aspects of the privatization process, including execution of the necessary agreements with labour unions, financial institutions and other creditors, compliance of the formalities under the Companies Act 1956 and transfer of control and management to the new owners.

## 6. Concluding Remarks

India is in a deep fiscal crisis which is largely the result of the unrelenting growth in inefficient public spending, including massive spending by public enterprises on projects the returns from which have generally been substantially less than the interest cost involved. One can assert that the crisis poses major risks for the success of India's reforms programme. Privatization of public enterprises can be of substantial help in meeting this crisis. Privatization can also be expected to contribute to making the Indian economy more efficient and competitive.

Although many privatization moves have been made, they do not add up to much: assets of the public enterprises that have been privatizied so far do not add up to even 1% of the total assets of India's huge public enterprise sector. The explanation fur this lies in the structure of incentives that India's politicians face and the labour unions' opposition to privatization. But a careful assessment of the Indian scenario suggests that pressures for privatization are building up, that given these pressures the obstacles to privatization may start wearing down, and that as a result of all this the supply of privatization in India can be expected to match the demand for it. This suggests a strong case for some serious thinking on the privatization issue in *India.*

One question arises: Can privatization provide a permanent solution to India's fiscal crisis? No. The permanent solution to India's fiscal crisis lies in practising fiscal discipline, not in simply talking about it.

## Notes

1/ The figure of 4.7% of GDP was arrived at after treating the proceeds from the proposed sale of selected public enterprises' equity as a receipt (above-the-line) item, which is incorrect. If an adjustment is made for this, the GOI's deficit projected for the current year (1993-94) moves up to 5.2% of GDP.

2/ For an analysis of recent trends in public spending on the maintenance of economic assets, *also see* Rao and Sen (*1993*).

3/ The proceeds from the sale of public enterprises should be treated as *a* financing (below-the-line) item, not as *a* receipt (above-the-line) item. A major advantage of such a treatment is that it eliminates all possible incentives to reduce a given public sector deficit with no or relatively small fiscal correction (Gupta 1993; also see Gupta and Levy 1993; and United Nations Development Programme 1993).

4/ The strategy's other components include: dilution of the list of industries reserved for the public sector, with nine industries (e.g., air transport; iron and steel; shipbuilding; and electric power) taken off the list and with private sector participation selectively allowed even in the remaining eight industries on the list; restructuring or closure of patently unviable public enterprises; stoppage of budgetary support to finance losses of public enterprises; progressive reduction in budgetary support to finance investment outlays of public enterprises; and strengthening of the system of monitoring public enterprises" performance through Memoranda of Understanding.

5/ Nothing else has changed. As Vaghul (1993, pp. 7-8) has put it: "There is no change in so'far as the public (enterprise) sector management is concerned. The structure of the public (enterprise) sector is not changed. The relation between the government and the public (enterprise) sector has remained the same."

6/ The Gujarat Chief Minister is reported to have appointed supporters of one of his political rivals as chairpersons of Gujarat's major public enterprises such as Gujarat Industrial Development Corporation and Gujarat State Export Corporation (see The Economic Times 1994).

7/ The privatization of Allwyn Nissan Limited (ANL), for example, posed no such problem as in this case the buyer, Mahindra and Mahindra Limited, agreed to "protect the rights and service conditions of the employees on the payroll of ANL, abide by the written commitments of the present management to them and not envisage any reduction in the overall workforce" (Reddy 1992, p. 180).

8/ This is what, one can argue, the GOI's Committee on Disinvestment of Shares of Public Sector Enterprises {Government of India 1993b, p. 10) also appears to be implying -- "the percentage of equity to be disinvested", as the Committee has put it, "should be generally under 49 per cent in industries reserved for the public sector and over 74 per cent in other industries." My interpretation of the Committee's recommendations, however, is that the Committee is not aiming at privatization, although some privatization might take place with private firms acquiring controlling interests through equity purchases in the market. But that may take a lot of time to happen. So the immediate purpose of the whole exercise appears to be just to enable the GOI to raise money.

9/ For an analysis of the impact of social obligations on a major public enterprise's reported profits, see Gupta (1988).

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